Gas liberalization in Europe

An empty promise?

Because pipelines remain monopoly-controlled, end users are being denied the lower prices that competition was intended to produce. More, higher-liquidity gas hubs could be part of the solution

By William Powell

American companies have been coming to Europe in waves to exploit the opportunities available in the liberalizing energy sector. Gas and power transmission and supply are now theoretically traded freely among market participants, who at first compete to offer the best price and service to larger end users. The ultimate aim is to lower the consumption threshold so that every consumer in the region can benefit. Given the value of the business, it is not surprising that some new players paid a premium to enter the market, beginning in Great Britain, which was the first to open up.

Yet the opportunities dangling enticingly before the eyes of investors on the Continent appear to be a mirage. Liberalization has proved an empty promise in such major markets as Germany, where the highly complex market structure and the ex-post system of regulation combine to defeat all comers that don't own pipeline capacity. In the case of gas, this has much to do with the lack of political will to bulldoze through reforms. Pipeline operators have negotiated with customers a lower price and charged competitors

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higher rates for using their pipelines than they charge their own supply arm. And they continued until a few years ago to contract for gas on long-term contracts stretching decades ahead, so that retention of market share to dispose of this gas is vital to their profitability.

Great Britain had an aggressive regulator who believed that third-party access to pipelines had to be on an open and transparent basis, and the result was the signing of a network code in early 1996. This predated by four years the effect of the EU gas directive, which lets member states decide whether to opt for negotiated or regulated third-party access. But trading and supply remain firmly in the hands of the pipeline operators, which have retained their monopolies. The French state still owns all of Gaz de France and Electricité de France, for example. Unsurprisingly, it is headline news there when a new entrant lures away a major customer.

Elsewhere, Italy and Spain have introduced a "release gas" program to prime the pumps of competition. In Italy, the regulator has introduced a set of tariffs based on an entry/exit system, and part of the pipeline network—Snam Rete Gas—has already been floated off from ENI SpA, which is one-third owned by the state.

Italy has a gas regulator, but it has no jurisdiction over capacity owned by Snam in neighboring countries' pipelines. Thus, companies trying to sell gas from eastern Europe find that their gas is "stuck" on the wrong side of the border. The situation in the power market, which is more open, isn't much better: Rules are obstructive for marketers, and tariffs high for customers. For example, U.S.-based Mirant, Atlanta, which plans to build or buy several gigawatts of generating capacity in Italy, says it finds local rules for trading electricity vague at best.

Small wonder then, that as Great Britain anticipates a gas supply deficit by 2005, it is doing what it can to promote transparency on the Continent. To avoid being at the mercy of opaque market forces, it is pressing for the creation of gas trading hubs on the Continent.

So far, the most liquid trading point outside Great Britain in Europe is Zeebrugge, Belgium. But it is little more than a satellite of the British national balancing point. Even though Zeebrugge is the "junction box" for Norwegian and British pipeline gas and for liquefied natural gas from anywhere, for the first few years of its existence its poor performance has weakened confidence and reduced liquidity. Neither Great Britain's National Balancing Point (NBP) nor Zeebrugge hubs come close to matching the Henry Hub's "churn" in the U.S. Where Henry Hub sees each unit traded 100 times before being delivered to the final consumer, gas at the NBP is only traded 15 times and at Zeebrugge about a third of that.

The east is ready

However, there are hopes of replicating the Henry Hub's performance farther east on the Germany-Netherlands border, and southeast on the Austria-Slovakia border. Near both borders, there is plenty of storage capacity and no shortage of pipeline connections. At the first site, the most likely development would be done by a joint venture run by an independent body—a NorthWest Europe Hub Co.—and founded by Germany's Ruhrgas and BEB, Germany's largest gas producer. Later Norwegian Statoil joined them.

These three entities have proposed setting up a hub with balancing and backup or backdown services by the fourth quarter of 2002. It would unite pipelines at Bunde, Germany; Emden Germany; and Oude Statenzijl, Netherlands, providing a single pricing point for Norwegian, Dutch, British, and other gas. However, the hub's acceptance will hinge on its ability to offer transparent and nondiscriminatory access to all. Statoil, whose participation is driven partially by its desire to capture the share of downstream margins it currently does not receive from sales to some European marketers, will help in this direction.

The second proposed hub, possibly at Baumgarten, Austria, would mainly serve as a transit point for Russian gas on its way to western Europe. For example, Gazprom's sales to Italy are delivered there, with Italy responsible for onward transportation within its borders.

Hubs at each location would reduce the need for gas to flow physically by providing pricing points. A buyer at one hub would just pay the premium—or receive the discount—from the seller at the other. The parties would trade using a standard contract, which is now being developed for the market to refine. Nominations to pipeline operators would be matched electronically with the buyer and seller, and title would be tracked automatically, allowing incorrect quantities to be made up. The cost of this process would be paid for by the party responsible, and determined on the basis of market prices, which would be published independently by organizations such as Platts. ■

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